Service Date: July 1, 1987

DEPARTMENT OF PUBLIC SERVICE REGULATION
BEFORE THE PUBLIC SERVICE COMMISSION
OF THE STATE OF MONTANA

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IN THE MATTER of the Montana Public Service Commission's Investigation of Federal Tax Reform Impacts on Public Utility Revenue Requirements.	)))))	UTILITY DIVISION DOCKET NO. 86.11.62 ORDER NO. 5236d

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ORDER ON RECONSIDERATION

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Introduction

On June 8, 1987, the Montana Public Service Commission (MPSC or Commission) issued Order No. 5236c in this Docket. Order No. 5236c set forth the Commission's conclusions regarding interpretation and application of the Tax Reform Act of 1986 (TRA).

Motions for Reconsideration were received from Montana Power Company (MPC), Pacific Power & Light (PP&L), Mountain Bell (MB), and Northwestern Telephone Systems (NT). This Order addresses the concerns and arguments raised in those motions.

Tax Rate

MPC, MB and NT all take issue with the Commission's conclusion that a 34 percent tax rate should be recognized as of July 1, 1987, for ratemaking purposes.

The companies claim that application of the 34 percent rate is unfair because rates collected during the first half of 1987 would not have covered their estimated cost-of-service and, therefore, would not have provided for a 46 percent tax rate. The Commission finds no merit in this argument. The important fact is that rates for these companies during the first half of 1987 have been based on a 46 percent tax rate; they have had an opportunity to earn their authorized rates of return after paying Federal taxes at that rate. There is no guarantee that the authorized rate of return will be achieved. It should also be noted that, regardless of fluctuating revenues and expenses, the tax rate applied to income remains the same. Finally, the Commission exempted PP&L and MDU electric from application of the 34 percent rate because those companies' authorized rates had earlier been recalculated on the basis of a 40 percent tax rate, not because they had failed to actually achieve their authorized rates of return.

MPC asserts that recognizing the 34 percent rate on July 1, 1987, is inconsistent because "many of the additional costs that result from the Tax Act were put in place January 1, 1987, while the tax rate decrease is not effective until July 1, 1987." (MPC Brief, p. 4) What MPC fails to recognize, however, is that no rate order, interim or otherwise, was issued prior to July 1, 1987. When that occurs, those tax changes will be recognized at the level which will apply to future tax liability. These tax changes are

not tied to the change in tax rates as evidenced by the fact that implementation dates are different.

MPC contends that recognizing a 34 percent tax rate on July 1, 1987, results in retroactive ratemaking. MB, on the other hand, claims that the result is "mov(ing) a full six months into 1988," thus violating test year principles. The Commission rejects both arguments.

The Commission is properly recognizing a tax rate change that occurs on July 1, 1987. A company with a fiscal year beginning on that date will be immediately subject to the 34 percent marginal rate. The fact that the TRA uses a blended rate for calendar year-end companies should not control ratemaking treatment for those tax changes. The critical consideration for ratemaking is whether the utilities' rates will provide them with an opportunity to recover their current tax expenses. Application of the Commission's conclusion in Order No. 5236c should provide that opportunity. Simply because the same result might have been achieved by recognizing a 40 percent rate on January 1, 1987, does not foreclose achieving the same result by recognizing the 34 percent rate change on July 1, 1987. In fact, the latter option has the distinct advantage of avoiding yet another rate change on January 1, 1988.

The Commission does not believe that matching princi ples are violated. It should first be noted that responding utilities chose test years which were most convenient to them. This Docket is unique in that several test periods are involved. The question seems to resolve into whether the change to 34 percent is effective on July 1, 1987, or January 1, 1988. We believe that for purposes of ratemaking, the change should be recognized as of July 1, 1987.

In fact, 1987 is a transitional year. The clear intent of the TRA was to effectuate a tax rate of 34 percent as of July 1, 1987. As noted above, companies with appropriate fiscal years must go directly to that rate. While other companies use a blended rate, that does not foreclose ratemaking treatment which places all the companies on the same footing and provides a fair opportunity to recover expenses and earn authorized returns.

Deferred Taxes

In Order No. 5236c, the Commission required utilities to write-off certain excess deferred taxes paid by ratepayers over a two year period. PP&L asked that the Commission reconsider or clarify this part of the Order. PP&L is concerned that this provision could require the accelerated amortization of deferred tax balances that are not affected by the TRA. These items represent one-time tax benefits that have been spread over the life of the related assets for ratemaking purposes. Prospective changes in tax rates do not affect the amount of the tax benefits. Under these circumstances there is no "excess deferred tax" and no adjustment is appropriate.

Paragraph Nos. 16 and 17 in Order No. 5236c relate to book/tax timing differences and the excess deferred taxes that result from a utility deferring taxes at 46 percent and paying the taxes at 34 percent. The Commission did not address, and did not intend to address, the proper treatment of any deferred tax balances related to permanent book/tax differences. If situations exist where utilities recorded taxes for book or ratemaking treatment and were not required to pay those taxes in that year or in future years then permanent differences exist. By definition,

there would be no excess deferred taxes related to these permanent differences. The Commission did not intend that any portion of these deferred tax balances be amortized faster than they would have been absent the Tax Reform Act.

Contributions in Aid of Construction (CIAC)

PP&L requests that the Commission modify its position regarding contributions in aid of construction (CIAC). The TRA raises the question of who should be responsible for the additional tax resulting from the change in treatment of CIAC. In Order No. 5236c, the Commission decided that the increased income tax resulting from CIAC should be collected from the contributor. PP&L's motion has not persuaded the Commission that a change in its original decision is warranted. The Commission decision requiring the utility to collect from the contributor the income tax effect of the CIAC does not represent a change from previously established policy. This approach recognizes the philosophy of this Commission that, to the extent possible, cost recovery should be from the cost causer.

The PP&L motion for reconsideration indicates that there is uncertainty on the part of utilities regarding the calculation of the contributors' tax liability. The Commission intends that the contribution be calculated as a net amount that reflects a credit to the consumer for the present value of the future depreciation tax benefit. This means that the discount rate will be determined only once at the time of the contribution.

At page 3 of its brief, PP&L asserts that the decision increases the charges for utility service without an opportunity for hearing, in violation of 69-3-303 and 2-4-601, MCA. We dis-

agree. Order No. 5236c simply states that CIAC will not be included in income for ratemaking and will not affect the general ratepayer's rates. The cost causer will pay the cost. The Order does not, of itself, increase rates. It recognizes that the TRA has increased the cost of CIAC, and concludes that those costs are not properly borne by the general ratepayer. Moreover, Finding of Fact No. 46 clearly states that affected utilities have until August 1, 1987, to file proposed methodologies for making these calculations. If at that time it is apparent that a hearing or rulemaking is appropriate, the Commission will allow all interested parties the opportunity to be heard.

Reserve for Bad Debt

PP&L asserts that the Commission's conclusions regarding reserve for bad debt should not be implemented because they represent a change in ratemaking practice that is not required by the TRA. The Commission believes that nothing in the TRA explicitly mandates a ratemaking change. The changes are mandated by the utilities' statutory duty to charge just and reasonable rates. §69-3-201, MCA. Finding of Fact Nos. 54 and 55 are consistent with the Commission's conclusions throughout Order No. 5236c that utilities must change their rates to reflect the changes flowing from the TRA. Utilities will be restoring to income the bad debt reserves, which are ratepayer provided funds. The ratepayer is entitled to recognition that those funds were noninvestor supplied and the mechanism outlined in the order represents a reasonable approach for that recognition.

Miscellaneous

MPC states that the intended effect of Order No. 5236c is unclear. The Order is exactly what it purports to be: established interpretations of the TRA which will be used to evaluate responsive filings in this Docket. The result of this evaluation will be a preliminary conclusion that existing rates are, or are not, just and reasonable based on data filed by the responding utilities. If a utility's existing rates appear to be excessive after accounting for TRA changes, the Commission will set a hearing and establish a procedural schedule. In cases where hearings are scheduled, interim orders may be issued. If existing rates do not appear to be excessive, the Commission intends to request comments on proposals to close particular sub-dockets. This approach is set forth in Ordering Paragraphs 1-4 of Order No. 5236c.

MPC asks whether Order No. 5236c is a final resolution of these tax issues "even for utilities which might be involved in further contested case proceedings in this docket." The Commission believes that parties have had an adequate opportunity to address these TRA issues, and expects that they will not be continually revisited. The conclusions in Order No. 5236c will be taken as final for interim purposes in this Docket, just as if they had been established in a prior proceeding. Conclusions such as these are never unchangeable, however. If the Commission is convinced that its interpretations are incorrect, they may be modified prior to issuance of final rate orders. This is no different than changing any other established precedent.

CONCLUSIONS OF LAW

1. The Commission has authority to supervise, regulate and control public utilities. Section 69-3-102, MCA.

2. Respondents are public utilities subject to the Commission's jurisdiction. Section 69-3-101, MCA.

3. The Commission may regulate the mode and manner of all investigations and hearing of public utilities. Section 69-3-103, MCA.

ORDER

The motions of Montana Power Company, Mountain Bell, Pacific Power & Light, and Northwestern Telephone Systems for reconsideration of Order No. 5236c are denied.

DONE AND DATED this 30th day of June, 1987, by a vote of 4-1.

BY ORDER OF THE MONTANA PUBLIC SERVICE COMMISSION

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CLYDE JARVIS, Chairman

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JOHN B. DRISCOLL, Commissioner

_____
DANNY OBERG, Commissioner

_____
HOWARD L. ELLIS, Commissioner

_____
TOM MONAHAN, Commissioner
(Voting to Dissent)

ATTEST:

Ann Purcell
Acting Secretary

(SEAL)

NOTE: You may be entitled to judicial review of this matter. Judicial review may be obtained by filing a petition for review within thirty (30) days of the service of this order. Section 2-4-702, MCA.